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The Manufacturers Hanover
Financial Digest
Weekly Commentary, Selected Financial Data, and Business Indicators

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Another Drop In GNP

For the third year in a row, the U.S. economy contracted in the second calendar quarter. The gross national product adjusted for inflation fell at an annual rate of 1.9 per cent in second-quarter 1981; it plunged at a 9.9 per cent clip in 1980's second quarter and declined at a 1.7 per cent pace in the second quarter of 1979. Although not as bad as last year, 1981's decline is more serious than it looks. This is because there was a substantial increase in business inventories. The way the GNP numbers are put together, a stepup in the rate of stockpiling—for whatever reason—adds to the GNP. But this can not really be considered as a sign of strength, since sales to final consumers fell by an annual rate of almost five per cent.

The declines in the components of real final sales were widespread as they occurred in every major economic sector. Nonresidential fixed investment slipped six per cent at a seasonally adjusted annual rate, residential spending dropped by almost 20 per cent, the trade balance worsened and total government purchases—with the exception of Federal defense spending—declined. Finally, inflation adjusted consumer spending fell by 1.9 per cent, paced by a 23.5 per cent drop in credit-sensitive purchases of durable goods.

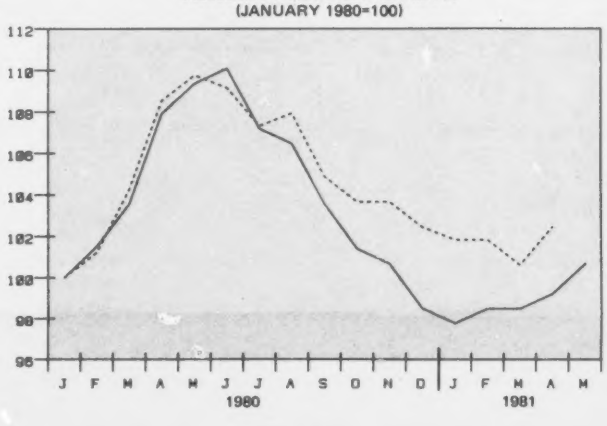
But this cloud had a silver lining. The Commerce Department reported a marked slowing in the rate of inflation. Measured by the GNP implicit deflator, prices rose at an annual rate of only six per cent in the second quarter, compared with a 9.8 per cent rate of rise registered during the previous period.

The Runup In Inventories . . .

Although some inventory buildup was expected, the magnitude of accumulation was surprising since most manufacturers, retailers and wholesalers have supposedly been keeping inventories lean. One reason for this belief is the repeated declines in economic activity referred to above—which were accompanied by repeated forecasts of further declines by many economists. Another—at least since the beginning of last year—has been high financing charges. But after a three-quarter drawdown which followed last year's recession, the value of inventories, after adjusting for inflation, surged $9.7 billion at an annual rate. Since inventories were liquidated at a $1.4 billion clip in the first quarter, this signifies a turnaround of $11.1 billion, which is the largest one-quarter swing in the past five years.

However, some accumulation was needed. Most businesses, particularly in the trade sector, let their inventory levels get too low as a byproduct of this year's combination of high interest rates and unexpectedly strong final sales. Although inventory-to-sales ratios have been climbing for the past few months (see chart), they remain well below last year's high levels—both nominally, and after adjusting for inflation.

MANUFACTURING & TRADE INVENTORY-TO-SALES RATIO (LINE) VS. MANUFACTURING & TRADE INVENTORY-TO-SALES RATIO ADJUSTED FOR INFLATION (DOT) (JANUARY 1980=100)



Nevertheless, the sharp increase in the value of inventories does not augur well for the GNP in the current quarter. Unless final sales pick up substantially, some manufacturers may be forced to trim production schedules even further to lighten the loads in their warehouses. And with interest rates likely to remain both high and volatile (Financial Digest—July 20, 1981), such a pickup in final sales may be long in coming.

Looking beneath the surface, the most dramatic upswing in inventories occurred in automobiles. This

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happened in sharp contrast to the first-quarter trend, when, with the help of substantial price rebates, stocks of autos were drawn down to a 44-day sales supply. Since then, car manufacturers have stepped up production not only to replenish inventories but also to prepare for summer plant closings to accommodate vacations and retooling for the new model year. However, slumping sales caused producers to overshoot, sending inventories far over their optimal levels.

On July 1, auto stocks shot up to a record 83½ days' supply. This is two-thirds greater than normal for this time period. During the second quarter, new-car sales fell by 25 per cent compared with the previous quarter to a seasonally adjusted 5.6 million unit rate. What is more, during the last ten-day selling period of the quarter, the sales rate plunged to a 30-year low, as sales ran at a 4.7 million unit rate. But because of the way that the Department of Commerce puts the GNP numbers together, the effect of the buildup in auto inventories offset the decline in auto sales. As a result, new car output remained unchanged from the first quarter and did not contribute to the decline in real GNP.

Stocks of petroleum products are also out of line with demand, despite a six-month slide in produc-

Selected Federal Reserve Data

(Averages of Daily Figures—Billions of Dollars)

	Week Ending 7/15/81	$ Change Since Week Ago	$ Change Since Year Ago
Reserve Bank Credit			
U.S. Gov'ts and Agencies Owned Outright & RPs	132.223	+ 1.209	+ .071
Loans to Depository Inst.	1.295	– .571	+ .963
Float	3.153	+ .170	– 2.116
Total Reserve Bank Credit	147.049	+ .457	+ 3.804
Treasury Deposits with Federal Reserve Banks	3.407	+ .473	+ .092
Currency Outside Banks	124.867	+ .551	+ 7.710
Member Bank Reserves:			
Required	40.495	+ .478	– 3.101
Excess (Deficiency)	.006	– .495	– .261
Total Reserves Held	40.501	– .017	– 3.362
Net Borrowed Reserves	1.042	– .082	+ .983
Gov'ts held for Foreign Acct. by F.R. Banks (End-of-Week)	96.262	– .108	+13.995
Monetary Aggregates†		**% Change Since Three Months Ago***	**% Change Since Year Ago**
M-1A	360.4	– 4.3‡	– 3.6‡
M-1B	428.9	+ 0.4‡	+ 8.3‡
M-2 (June '81)	1,749.3	+ 7.2	+ 10.1
L (April '81)	2,453.8	+ 7.6	+ 10.6

†Seasonally adjusted. *Seasonally adjusted annual rate. ‡Four-week moving average.

New York Money Market

Offering Rates 7/24/81	3 Months	6 Months	1 Year
‡U.S. Treasury Bills	14.90%	14.65%	13.65%
* Federal Agencies	15.60	16.30	15.30
* Project Notes—Taxfree (46% Taxable Equivalent)	12.59	14.72	NA
Negotiable Time CDs Manufacturers Hanover	Rates By Arrangement		
* Secondary Market—Prime	18.13	17.88	16.90

‡Finance Company Paper—Prime

5- 14 days	17.88%
15- 29 days	18.25
30- 59 days	17.63
60- 89 days	16.00
90-179 days	15.13
180-239 days	14.38
240-270 days	13.00

‡* Bankers' Acceptances

Aug.	18.00%
Sep.	17.60
Oct.	17.25
Nov.	17.10
Dec.	16.80
Jan.	16.40

‡Industrial Paper—Prime

30- 89 days	17.88%
90-120 days	17.50

†Federal Funds Effective Rate 18.75%

‡Discount basis. * Subject to availability. † Estimated.

Selected Business Indicators

(All Dollar Figures in Billions)

	Latest Period or End of Period		Previous Period	Year Ago Period
Gross National Product (Current Dollars)*	2nd Q'81n	$ 2,881	$ 2,853	$ 2,565
Gross National Product (1972 Dollars)*	2nd Q'81n	$ 1,509	$ 1,516	$ 1,463
Percent Change, Annual Rate	2nd Q'81n	– 1.9%	8.6%	– 9.9%
Change in Consumer Prices (all urban consumers)*	Jun '81n	8.4%	8.4%	12.0%
Change in Producer Prices*	Jun '81	7.2%	4.8%	9.6%
Civilian Employment (Thousands of Persons)†	Jun '81	98,392	99,235	96,780
Unemployment as % of Civilian Labor Force†	Jun '81	7.3%	7.6%	7.5%
Personal Income*	Jun '81n	$ 2,382	$ 2,368	$ 2,127
Leading Indicators Composite Index (1967=100)†	May '81	135.2	137.7	123.0
Industrial Production Index (1967=100)†	Jun '81	152.7	152.8	141.5
Net Change in Consumer Installment Credit†	May '81	$ 1.35	$ 2.33	–$ 2.68
U.S. Merchandise Trade Balance†	May '81	–$ 2.44	–$ 2.47	–$ 2.94
Plant and Equipment Expenditures*	3rd Q'81	$322.88(a)	$317.29(a)	$296.23
Private Housing Starts (Thousands of Units)*	Jun '81	1,032	1,159	1,184
New Construction Expenditures*	May '81	$ 237.3	$ 248.9	$ 218.9
Total Business Inventories†	May '81	$ 477.8	$ 474.6	$ 450.3
Total Business Sales†	May '81	$ 344.2	$ 345.7	$ 298.0

*Seasonally adjusted annual rate. †Seasonally adjusted. n-Newly reported figure. a-Anticipated.

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tion of refined petroleum. In fact, many refiners have been operating at 50 to 60 per cent of capacity lately, compared with a 93 per cent utilization rate at the beginning of 1979.

The dismal condition of the housing sector had a significant negative impact on the GNP in several areas. For one thing, the precipitous drop in housing starts and completions resulted in a 17 per cent decline at an annual rate in the value of real residential investment. Furthermore, as purchases of new and existing homes slipped and new-home construction came to a halt, demand for such household goods as appliances and furnishings declined significantly thus contributing to the decline in personal consumption expenditures.

The strong dollar and the weakness in the economies of our trading partners also affected the GNP accounts. Inflation-adjusted exports were no higher in the second quarter than they were a year ago, while imports grew by five per cent during the same time period. During the second quarter of 1981, U.S. exports fell by a seasonally adjusted annual rate of 5.3 per cent compared with the first, after adjusting for inflation, reflecting the decline in the price competitiveness of U.S. exports. Despite a decline in imports of oil, total imports rose ten per

Short Term Paper Outstanding

(Millions of Dollars)

	Latest Week	Change Since Week Ago	Change Since Year Ago
Negotiable Time CD's Weekly Reporting Banks			
Nationwide (7/8/81)	122,410	– 362	+32,129
New York City (7/8/81)	29,395	– 432	+ 8,215
Commercial Paper (7/8/81)	151,553	+ 2,502	+26,795

Bank Loans

(Millions of Dollars)

Commercial and Industrial Loans

Weekly Reporting Large Commercial Banks	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (7/8/81)	181,532	– 970	+22,380
New York City (7/8/81)	53,544	– 12	+ 6,097

Total Loans Gross Adjusted

	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (7/8/81)	443,659	– 6,486	+48,387
New York City (7/8/81)	106,416	– 3,299	+16,933

Financial Markets

	Friday 7/24/81	Change Since Week Ago	Change Since Year Ago
U.S. Governments, Closing Yields:			
90-Day Bills†	15.60%	+ .51	+ 7.38
180-Day Bills†	16.00	+ .47	+ 7.55
Longest Bills†	15.70	+ .41	+ 7.06
Recent Issues:			
15⅞s 7/31/81 (When Issued)	15.56	NA	
14s 6/30/85	15.30	+ .68	
14½s 5/15/91	14.36	+ .30	
13⅞s 5/15/11	13.60	+ .22	
Municipals:			
Bond Buyer–20 Bond Index* (7/23/81)	11.34%	+ .25	+ 3.15
Blue List Total ($ Million)	$ 912	– $ 39	– $ 168
30-Day Visible Supply ($ Million)	$1,675	+ $ 10	– $ 428
Total	$2,587	– $ 29	– $ 596
Corporates:			
Moody's Aa Composite (7/23/81)	15.12%	+ .43	+ 3.60
Money Mgr.–30-Day Supply ($ Million)	$7,787	– $211	+ $4,001
Stocks:			
Dow-Jones Averages:			
Industrials	936.74	– 22.16	+ 18.65
Transportation	402.17	– 9.23	+ 98.27
Utilities	107.57	– .82	– 5.36
65 Stocks	366.05	– 7.68	+ 32.37
Standard and Poor's 500 Stocks	128.44	– 2.32	+ 7.66
N.Y.S.E. Composite Index	74.60	– 1.36	+ 5.50
N.Y.S.E. Avg. Daily Vol. for Week (000's)	43,194	+ 340	– 756

* 46% Taxable equivalent 21.00%.

† Bond equivalent.

International Rates

EURODOLLAR DEPOSIT RATES (bid)	Friday 7/24/81	Week Ago
Overnight	18.75%	18.38%
1 month	19.44	18.50
3 month	19.19	18.56
6 month	18.88	18.25
1 year	17.63	17.00
EURODOLLAR BONDS		
Average Yield		
Medium Term (5 to 7 yrs.)	15.05%	14.80%
Long Term (7 to 15 yrs.)	15.00	14.70

FOREIGN EXCHANGE SPOT RATES New York Opening (7/24/81)	U.S. $ Equivalent	Currency Per U.S. $
Belgium	.02499	40.02
Canada	.8212	1.2178
Denmark	.1305	7.6603
France	.1721	5.8110
Germany	.4096	2.4415
Italy	.0008234	1214.50
Japan	.004259	234.80
Mexico	.0407	24.60
Netherlands	.3679	2.7180
Switzerland	.4738	2.1105
U.K.	1.8520	.5400

cent, as many foreign-made goods became cheaper in dollar terms. This trend will continue as long as the dollar remains strong.

. . . Suggests Further Weakness

The high level of inventories and the housing slump have already resulted in production cutbacks. Industrial production at the nation's factories and mines slipped one-tenth of one per cent in June. This was the first monthly drop since February. The decline would have been even steeper were it not for a rise in coal production—as striking miners returned to work—and a greater than seasonal generation of electricity.

The output declines were widespread among durable and nondurable goods industries. Importantly, production of paper and paperboard fell for the third consecutive month. Output of paperboard in particular is considered a good coincident indicator of the economy, since much is used for packaging various products. Substantial month-over-month declines were registered in the production of home goods. Output of appliances such as radio and television sets has declined by 12 per cent in the past two months.

There are still some areas of the economy that have not been affected by the slowdown. These include industries that produce such high technology products as communications equipment or electronic components. Additionally, defense-related industries are still growing, as Washington's defense spending continues to rise. H

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